TC03789

Appeal number: TC/2013/07244

Income Tax - Discovery assessment - Restriction of "sideways offset" of losses derived from capital allowances in respect of yacht chartering, when the lessor had not spent the whole of his time for a 6-month period in the tax year in question in carrying on the trade - Appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

ADRIAN SALMON

Appellant

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS

Respondents

TRIBUNAL: JUDGE HOWARD M. NOWLAN
MRS CAROL DEBELL

Sitting in public at 45 Bedford Square in London on 28 May 2014

The Appellant in person

Simon Bates of HMRC on behalf of the Respondents

DECISION

Introduction

1. This was an Appeal against a discovery assessment. The assessment had increased the assessments on the Appellant for the tax years 2007/2008 and 2008/2009 because it was only belatedly that HMRC concluded that the Appellant had wrongly (and plainly innocently) claimed to set losses derived from capital allowances in his yacht chartering business against other income. It emerged that the Appellant had not, and conceded that he had not, spent the requisite amount of time involved personally in the business with the result that section 75 Finance Act 2007 precluded the relevant losses from being set against other income for Income Tax purposes. It was accepted that the Appellant had been unaware of the way in which section 75 had this effect, which was why his self-assessment return had assumed the sideways offset of the losses in the relevant business.

2. Discovery assessments are the assessments that can be made beyond the period for review of self-assessment returns, all in accordance with the provisions of section 29 Taxes Management Act, 1970. Various conditions have to be satisfied before they can be made, and in order to give the taxpayer an element of finality following the making of a return, section 29(5) provides that even where it is supposed that a person's return reveals an under-assessment of tax, the late discovery assessment cannot be made, provided there was no negligent conduct in the making of the return, if the return divulged sufficient information that the averagely competent HMRC inspector ought to be presumed to have been able, from that information thus given, to detect that there was an error in the return which ought to be corrected. This Appeal relates entirely to that issue.

3. The Appeal raises two issues that we must determine. The first is whether the Appellant's information provided in the return makes the facts clear that indicate the potential under-statement. The second is whether the notional inspector of average competence should have reached the conclusion that there was an under-statement on the basis of the information provided. To avoid repeating the first issue, that second question is asking whether the inspector should be assumed to have been aware of the relevant provision of tax law that actually renders the amount of income disclosed in the self-assessment tax return insufficient.

4. Our decision is that the Appellant's appeal fails on both grounds. The statement recorded in the self-assessment return was not sufficiently clear, in indicating the facts, to indicate that there was an under-assessment. It might have revealed to the very astute and knowledgeable inspector that there might be an under-assessment and that if the inspector asked more questions, the resultant answers might in fact then reveal an insufficiency of income. The law makes it clear however that the disclosed information must go further than to prompt further questions. It must reveal the facts that make the insufficiency clear provided the inspector is aware of the provisions that then occasion the under-statement. On the second point, the inspector is presumed to be an average inspector, having an average knowledge of tax law. The provision that undermines the correctness of the assessment in this case is a provision of fairly limited effect and we consider it reasonable to conclude that knowledge of the particular provision is not something that we would expect the average inspector to have.

5. We will now expand on both points.

The facts

6. The Appellant was an ex-army officer. He spent approximately 100 days a year in duties for the Territorial Army. The pay revealed in respect of that activity in his tax return, along with the nature of the activity, made it perfectly credible, indeed likely, that the activity was far from a full-time activity.

7. The Appellant had also purchased a yacht. He was a keen sailor from his army days and his initial plan was to charter out the boat to hirers, to generate income, with a view perhaps when he reached normal retirement age to using the yacht personally. We are solely concerned in this Appeal with the state of affairs when the boat was being chartered out, and indeed we understand that the yacht has recently been sold. Accordingly private use will never have been relevant.

8. The Appellant put much of the business of finding hirers for the boat in the hands of various different agencies at different times, each of which took a significant percentage of the hire fees for their work. The Appellant realised that most bookings for the yacht would be on a bareboat basis in which, in other words, the hirers would man and crew the yacht themselves. The Appellant was prepared to skipper the boat if ever potential hirers did not have the required qualification to man the yacht themselves, or if they simply wanted an experienced yachtsman to skipper the yacht. We understood, however, that it was unusual for the Appellant to be requested to skipper the yacht, and that most hirings were bareboat-style hirings when the hirers simply leased the yacht and operated it themselves.

9. Not that the Appellant was aware of the following point, the effect of section 75 Finance Act 2007 (the predecessor section having first been included in the tax legislation in 1994) precluded losses in respect of the leasing of plant and machinery that derived from the available capital allowances being set against other income unless the taxpayer in question spent half his time in "carrying on the trade". Time could be spent "in carrying on the trade" in the present context either by dealing with sufficient administrative work to demand personal attention to that work for the requisite period, or it might involve skippering the yacht, or indeed working on it, cleaning it and maintaining it etc.

10. In the Appellant's tax return, he described the business activity in relation to the yacht business as "Yacht charter and skippering". As we have already indicated he wrongly assumed that he could set the losses in this activity against other income of the same period, and failed to appreciate that the losses derived from capital allowances could only be so offset if he had spent the requisite time in the period in "carrying on the trade".

Background assumptions

11. Prior to addressing that issue we should first refer to the fact that it is accepted that where an activity involves more a provision of services than the leasing of an asset, the provision of section 75 is altogether irrelevant. For instance a taxi driver performs the service to his various customers of transporting them on individual journeys, and that activity would never realistically be regarded as one of leasing the vehicle. By contrast, short-term leasing of a rent-a-car at an airport is obviously a leasing activity. Moving slightly closer to the yacht situation, it is apparently accepted that where crane services are provided, almost invariably with an operator, the analysis in that situation is that there is treated as being a supply of a service of assisting in construction operations, and there is not analysed to be a lease of a crane.

12. We consider it clear in the present case, particularly because most of the hirers of the Appellant's yacht skippered and crewed the yacht themselves that the Appellant's activity was a trading activity that involved leasing, and not a service trade. If he exceptionally skippered the yacht, he took a separate fee for that work, but both the charter income and the

fee for skippering were obviously the revenues of the one single trade. On account of the great preponderance of bareboat chartering, we conclude on the issue that was barely mentioned before us that the trade in question was one that did involve leasing plant, and that accordingly section 75 was potentially relevant to restrict the sideways offset of allowances.

13. Once we reach that conclusion, the Appellant accepted that he had not spent the requisite time in attending to the trade, with the result that the provision of section 75 did bite, and preclude the losses derived from the capital allowances being offset against other income.

Our decision

14. The questions that we must address all relate to the wording of section 29(5) Taxes Management Act 1970. So far as is presently material that sub-section permits a discovery assessment to be made, outside the ordinary window for opening enquiries into tax returns if at the end of the period during which an enquiry can be opened, or on the issue of a closure notice, where an enquiry has been undertaken, it can be said that *"a notional inspector could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation mentioned in subsection (1) above."* The reference to *"the situation mentioned in subsection (1) above"* means broadly that *"the income disclosed in the return indicates a possible under-statement of income"*.

15. The Appellant's basic contention was that his description of his business as "yacht charter **and** skippering" made it clear that there were two separate activities, and that it was obvious that the first, "yacht charter" involved bareboat chartering. The inspector was therefore on notice that the activity or at least one distinct aspect of the activity involved the inherently largely passive activity of letting out a yacht on a bareboat basis and that therefore the Appellant could not have satisfied the requirement of section 75. Accordingly the inability to offset the allowances against other income should have been obvious to the inspector and the notional inspector should now be precluded from making a discovery assessment.

16. We do not agree with the contention that the description in the return indicated that the activity fundamentally involved bareboat chartering. It might equally have been referring to the situation in which the Appellant would invariably have skippered the yacht. Equally, it was an appropriate description of the business where on some occasions the yacht was chartered on a bareboat basis, and occasionally on a skippered basis.

17. The reported cases make it clear that the matter that must be revealed by the taxpayer's information in the return (and other presently irrelevant material) is the factual situation that indicates an "under-assessment", and not just a state of affairs that might indicate that the inspector might well ask further questions and the answers to those questions might reveal that there has been an under-assessment.

18. In the present case, even if the Appellant had indicated that his business was simply one of "bareboat chartering a yacht", it was still possible that the Appellant might have been engaged in the requisite sense in carrying on the business. He might have worked extensively in marketing and administration, he might have spent countless hours cleaning and maintaining and repairing the yacht in the numerous periods when it was off-hire, and he could have satisfied the active involvement test of section 75. As it is, since it was reasonably apparent that his Territorial Army activity was far from full time, and as he had indicated that his business (and it was clearly one single business) also involved skippering the yacht, the possibility that he would have satisfied the "active involvement" test of section 75 was even more a realistic possibility. In any event, reverting to the legal point made in

paragraph 16 no inspector could have concluded that he failed the section 75 test on the information provided in the return without reverting to the Appellant, and asking him to clarify how much active involvement he had had in the business.

19. Accordingly, on the first point, we consider that the Appellant fails to demonstrate that the Inspector was shut out from making a discovery assessment by the information provided in the return. This conclusion is itself sufficient to justify us in dismissing the Appeal.

20. We have already indicated that, even if our above conclusion was wrong, and in other words the correct conclusion was that the divulged information gave all the required facts to demonstrate an under-assessment, HMRC would still not be precluded from raising a discovery assessment if we conclude that the average inspector should be assumed to have been ignorant of the rule in section 75. We consider it reasonable to assume that the average inspector should appreciate the basic rules for carrying back loss relief to an earlier period or periods, the usual ability to set loss relief sideways against other income, and then the indefinite ability to carry excess trade losses forward against later profits of the same trade. We consider that it is fairly well known that there are restrictions on loss relief in the context of "hobby farming", albeit that few will come across that particular situation. We are inclined to think that the restriction on sideways utilisation of losses, in the present context of a trade that involves plant leasing, is a feature of tax law confined to a very narrow situation, and not one that it is realistic to presume that the average inspector would be aware of. It may not be particularly complex and difficult to understand but its relevance is confined essentially to a fairly narrow sphere of activity, and that activity is not that common. We accordingly conclude that there is no ground for saying that the average inspector should be assumed to have realised that the statutory provisions would have demonstrated an under-assessment of tax, even if the Appellant had made it clear that he was wholly uninvolved with the active conduct of the relevant business.

21. That, however, is certainly not what the description in the tax return indicated and our decision on both grounds is that HMRC was not shut out from making a discovery assessment in this case. The information given in the return did not identify or point to an under-assessment. At most it might have prompted the knowledgeable inspector to ask further relevant questions, but that is not sufficient to preclude the discovery assessment. Furthermore, the provision in section 75 is one of fairly limited relevance and we consider it unrealistic to assume that the average inspector should be assumed to have been aware of it.

22. The Appeal is accordingly dismissed.

Right of Appeal

23. This document contains full findings of fact and the reasons for our decision in relation to each appeal. Any party dissatisfied with the decision relevant to it has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) Tax Chamber Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

HOWARD M. NOWLAN
TRIBUNAL JUDGE

RELEASE DATE: 8 July 2014